

Whitestone REIT
Form 10-Q
August 02, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 000-50256

WHITESTONE REIT

(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or Other Jurisdiction of
Incorporation or Organization)

76-0594970
(I.R.S. Employer
Identification No.)

2600 South Gessner, Suite 500
Houston, Texas
(Address of Principal Executive Offices)

77063
(Zip Code)

(713) 827-9595

(Registrant's Telephone Number, Including Area Code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of August 2, 2010, the registrant had outstanding 10,461,093 Common Shares of Beneficial Interest, \$0.001 par value per share.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Whitestone REIT and Subsidiaries
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	June 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Real estate assets, at cost		
Property	\$ 193,283	\$ 192,832
Accumulated depreciation	(36,839)	(34,434)
Total real estate assets	156,444	158,398
Cash and cash equivalents	3,910	6,275
Escrows and acquisition deposits	6,149	8,155
Accrued rents and accounts receivable, net of allowance for doubtful accounts	4,515	4,514
Unamortized lease commissions and loan costs	3,743	3,973
Prepaid expenses and other assets	1,531	685
Total assets	\$ 176,292	\$ 182,000
LIABILITIES AND EQUITY		
Liabilities:		
Notes payable	\$ 100,837	\$ 101,782
Accounts payable and accrued expenses	7,628	9,954
Tenants' security deposits	1,666	1,630
Dividends and distributions payable	1,511	1,775
Total liabilities	111,642	115,141
Commitments and contingencies:		
Equity:		
Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding at June 30, 2010 and December 31, 2009, respectively	-	-
Common shares, \$0.001 par value per share; 400,000,000 shares authorized; 10,461,101 and 10,337,307 issued and outstanding as of June 30, 2010 and December 31, 2009, respectively	10	10
Additional paid-in-capital	70,330	69,952
Accumulated deficit	(28,036)	(26,372)
Total Whitestone REIT shareholders' equity	42,304	43,590
Noncontrolling interest in subsidiary	22,346	23,269
Total equity	64,650	66,859
Total liabilities and equity	\$ 176,292	\$ 182,000

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009 (revised)	2010	2009 (revised)
Property revenues				
Rental revenues	\$6,407	\$6,572	\$12,811	\$13,077
Other revenues	1,425	1,631	2,730	3,170
Total property revenues	7,832	8,203	15,541	16,247
Property expenses				
Property operation and maintenance	2,145	2,256	3,946	4,393
Real estate taxes	894	1,063	2,046	2,112
Total property expenses	3,039	3,319	5,992	6,505
Other expenses (income)				
General and administrative	1,272	1,625	2,472	3,054
Depreciation and amortization	1,759	1,710	3,493	3,418
Involuntary conversion	-	(51)	-	190
Interest expense	1,402	1,470	2,809	2,898
Interest income	(5)	(11)	(12)	(22)
Total other expenses	4,428	4,743	8,762	9,538
Income from continuing operations before loss on disposal of assets and income taxes	365	141	787	204
Provision for income taxes	(102)	(57)	(156)	(111)
Loss on disposal of assets	(8)	(12)	(41)	(53)
Net income	255	72	590	40
Less: Net income attributable to noncontrolling interests	89	25	207	14
Net income attributable to Whitestone REIT	\$166	\$47	\$383	\$26
Earnings per share – basic				
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.02	\$0.00	\$0.04	\$0.00
Earnings per share – diluted				
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$0.02	\$0.00	\$0.04	\$0.00
Weighted average number of common shares outstanding:				
Basic	9,845	9,707	9,783	9,707

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Diluted	9,900	9,899	9,899	9,910
Dividends declared per common share	\$0.0950	\$0.1125	\$0.2075	\$0.2250

See accompanying notes to Consolidated Financial Statements

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Whitestone REIT and Subsidiaries
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(Unaudited)
(in thousands, except per share data)

	Common Shares	Common Amount	Additional Paid-In Capital	Accumulate Deficit	Total Whitestone REIT Shareholders' Equity	Noncontrolling Interests Units	Noncontrolling Interests Amount	Total Equity
Balance, December 31, 2009	10,337	\$ 10	\$ 69,952	\$ (26,372)	\$ 43,590	5,444	\$ 23,269	\$ 66,859
Share-based compensation	172	-	21	-	21	-	-	21
Repurchase of common shares (1)	(48)	-	(249)	-	(249)	-	-	(249)
Dividends and distributions	-	-	-	(2,047)	(2,047)	-	(1,130)	(3,177)
Reclassification of dividend reinvestment plan shares with expired rescission rights to equity from liabilities at \$9.50 per share	-	-	606	-	606	-	-	606
Net income	-	-	-	383	383	-	207	590
Balance, June 30, 2010	10,461	\$ 10	\$ 70,330	\$ (28,036)	\$ 42,304	5,444	\$ 22,346	\$ 64,650

(1) During the three months ended June 30, 2010, the Company acquired Common Shares held by employees who tendered owned Common Shares to satisfy the tax withholding on the lapse of certain restrictions on restricted shares.

See accompanying notes to Consolidated Financial Statements

Whitestone REIT and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Six Months Ended June 30,	
	2010	2009 (revised)
Cash flows from operating activities:		
Net income	\$ 590	\$ 40
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,493	3,418
Loss on disposal of assets	41	53
Bad debt expense	220	464
Share-based compensation	143	497
Changes in operating assets and liabilities:		
Escrows and acquisition deposits	2,006	1,185
Accrued rent and accounts receivable	(221)	(1,201)
Unamortized lease commissions and loan costs	(362)	(292)
Prepaid expenses and other assets	263	222
Accounts payable and accrued expenses	(2,391)	(1,199)
Tenants' security deposits	36	30
Net cash provided by operating activities	3,818	3,217
Cash flows from investing activities:		
Acquisitions of real estate	-	(5,619)
Additions to real estate	(929)	(1,683)
Net cash used in investing activities	(929)	(7,302)
Cash flows from financing activities:		
Dividends paid on common shares and common share equivalents	(2,339)	(2,319)
Distributions paid to OP unit holders	(1,219)	(1,062)
Proceeds from notes payable	-	9,791
Repayments of notes payable	(1,447)	(1,008)
Payments of loan origination costs	-	(288)
Repurchase of common shares	(249)	-
Net cash provided by (used in) financing activities	(5,254)	5,114
Net increase (decrease) in cash and cash equivalents	(2,365)	1,029
Cash and cash equivalents at beginning of period	6,275	12,989
Cash and cash equivalents at end of period	\$ 3,910	\$ 14,018
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 2,872	\$ 2,668
Cash paid for taxes	\$ 262	\$ 223
Noncash investing and financing activities:		
Disposal of fully depreciated real estate	\$ 437	\$ 504
Financed insurance premiums	\$ 502	\$ 478
Accrued offering costs	\$ 666	\$ -

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Acquisition of real estate in exchange for OP units	\$ -	\$ 3,625
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See accompanying notes to Consolidated Financial Statements

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2010
(Unaudited)

The use of the words “we,” “us,” “our,” “Company” or “Whitestone” refers to Whitestone REIT and our consolidated subsidiaries, except where the context otherwise requires.

1. Interim Financial Statements

The consolidated financial statements included in this report are unaudited; however, amounts presented in the consolidated balance sheet as of December 31, 2009 are derived from our audited consolidated financial statements at that date. The unaudited financial statements as of June 30, 2010 have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information on a basis consistent with the annual audited consolidated financial statements and with the instructions to Form 10-Q.

The consolidated financial statements presented herein reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position of Whitestone and our subsidiaries as of June 30, 2010, and the results of operations for the three and six month periods ended June 30, 2010 and 2009, the consolidated statement of changes in equity for the six month period ended June 30, 2010 and cash flows for the six month periods ended June 30, 2010 and 2009. All of these adjustments are of a normal recurring nature. The results of operations for the interim period are not necessarily indicative of the results expected for a full year. The statements should be read in conjunction with the audited consolidated financial statements and the notes thereto which are included in our Annual Report on Form 10-K for the year ended December 31, 2009.

Business. Whitestone was formed as a real estate investment trust (“REIT”), pursuant to the Texas Real Estate Investment Trust Act on August 20, 1998. In July 2004, Whitestone changed its state of organization from Texas to Maryland pursuant to a merger of Whitestone directly with and into a Maryland real estate investment trust formed for the sole purpose of effectuating the reorganization and the conversion of each outstanding common share of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity (the “Common Shares”). Whitestone serves as the general partner of Whitestone REIT Operating Partnership, L.P. (the “Operating Partnership”), which was formed on December 31, 1998 as a Delaware limited partnership. Whitestone currently conducts substantially all of its operations and activities through the Operating Partnership. As the general partner of the Operating Partnership, Whitestone has the exclusive power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. As of June 30, 2010 and December 31, 2009, Whitestone owned and operated 36 commercial properties in and around Houston, Dallas, San Antonio, Chicago and Phoenix.

2. Summary of Significant Accounting Policies

Basis of Consolidation. We are the sole general partner of the Operating Partnership and possess full legal control and authority over the operations of the Operating Partnership. As of June 30, 2010 and December 31, 2009, we owned a majority of the partnership interests in the Operating Partnership. Consequently, the accompanying consolidated financial statements include the accounts of the Operating Partnership. All significant inter-company balances have been eliminated. Noncontrolling interest in the accompanying consolidated financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than us. Net income or loss is allocated to noncontrolling interests based on the weighted-average percentage ownership of the Operating Partnership during the year. Issuance of additional Common Shares and units of limited partnership interest in the Operating Partnership that are convertible into cash or, at our option, Common Shares on a one-for-one basis (the “OP Units”) changes the ownership interests of both the noncontrolling interests and Whitestone.

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010

(Unaudited)

Basis of Accounting. Our financial records are maintained on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recorded when incurred.

Use of Estimates. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that we use include the estimated fair values of properties acquired, the estimated useful lives for depreciable and amortizable assets and costs, the estimated allowance for doubtful accounts and estimates supporting our impairment analysis for the carrying values of our real estate assets. Actual results could differ from those estimates.

Reclassifications. We have reclassified certain prior fiscal year amounts in the accompanying consolidated financial statements in order to be consistent with the current fiscal year presentation. These reclassifications had no effect on net income or equity.

Share-Based Compensation. From time to time, we grant nonvested restricted common share awards or restricted common share units which convert upon vesting to Common Shares, to trustees, executive officers and employees under our 2008 Long-Term Equity Incentive Ownership Plan (the "2008 Plan"). The vast majority of the awarded shares and units vest when certain performance conditions are met. We recognize compensation expense when achievement of the performance conditions is probable based on management's most recent estimates using the fair value of the shares as of the grant date. For the three months ended June 30, 2010 and 2009, we recognized \$0.1 million and \$0.3 million in share-based compensation expense, respectively, and for the six months ended June 30, 2010 and 2009, we recognized \$0.1 million and \$0.5 million, respectively.

Noncontrolling Interests. Noncontrolling interests is the portion of equity in a subsidiary not attributable to a parent. The ownership interests not held by the parent are considered noncontrolling interests. Accordingly, we have reported noncontrolling interests in equity on the consolidated balance sheets but separate from Whitestone's equity. On the consolidated statements of income, subsidiaries are reported at the consolidated amount, including both the amount attributable to Whitestone and noncontrolling interests. Consolidated statements of changes in equity are included for quarterly financial statements, including beginning balances, activity for the period and ending balances for shareholders' equity, noncontrolling interests and total equity.

See Whitestone's Annual Report on Form 10-K for the year ended December 31, 2009 for further discussion on significant accounting policies.

Recent Accounting Pronouncements. There are no new unimplemented accounting pronouncements that are expected to have a material impact on our results of operations, financial position or cash flows.

3. Accrued Rent and Accounts Receivable, net

Accrued rent and accounts receivable, net, consists of amounts accrued, billed and due from tenants, allowance for doubtful accounts and other receivables as follows (in thousands):

June 30, December 31,

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	2010	2009
Tenant receivables	\$1,674	\$ 1,770
Accrued rent and recoveries	3,811	3,636
Allowance for doubtful accounts	(979)	(894)
Other receivables	9	2
Total	\$4,515	\$ 4,514

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WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2010
(Unaudited)

4. Unamortized Leasing Commissions and Loan Costs

Costs which have been deferred consist of the following (in thousands):

	June 30, 2010	December 31, 2009
Leasing commissions	\$4,769	\$ 4,601
Deferred financing cost	2,236	2,208
Total cost	7,005	6,809
Less: leasing commissions accumulated amortization	(2,466)	(2,246)
Less: deferred financing cost accumulated amortization	(796)	(590)
Total cost, net of accumulated amortization	\$3,743	\$ 3,973

5. Debt

Mortgages and other notes payable consist of the following (in thousands):

Description	June 30, 2010	December 31, 2009
Fixed rate notes:		
\$10.0 million 6.04% Note, due 2014	\$9,576	\$ 9,646
\$11.2 million 6.52% Note, due 2015	10,965	11,043
\$21.4 million 6.53% Notes, due 2013	20,436	20,721
\$24.5 million 6.56% Note, due 2013	24,236	24,435
\$9.9 million 6.63% Notes, due 2014	9,630	9,757
\$0.5 million 3.25% Note, due 2010	251	-
\$0.5 million 5.05% Note, due 2010	-	52
Floating rate note:		
\$26.9 million LIBOR + 2.60% Note, due 2013	25,743	26,128
Total	\$100,837	\$ 101,782

As of June 30, 2010, we had \$100.6 million in notes secured by 21 properties with a carrying value of \$107.1 million. Our loans contain restrictions that would require the payment of prepayment penalties for the acceleration of outstanding debt and are secured by deeds of trust on certain of our properties and assignment of certain rents and leases associated with those properties. As of June 30, 2010, we are in compliance with all loan covenants.

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2010
(Unaudited)

Annual maturities of notes payable as of June 30, 2010 are due as set forth below:

Year	Amount Due (in thousands)
2010	\$ 1,398
2011	2,410
2012	2,543
2013	66,418
2014	17,799
2015 and thereafter	10,269
Total	\$ 100,837

6. Earnings Per Share

Basic earnings per share for Whitestone's common shareholders is calculated by dividing net income attributable to common shareholders excluding amounts attributable to unvested restricted shares by Whitestone's weighted-average common shares outstanding during the period. Diluted earnings per share is computed by dividing net income attributable to common shareholders excluding amounts attributable to unvested restricted shares by the weighted-average number of common shares including any dilutive unvested restricted shares.

Certain of Whitestone's performance restricted common shares are considered participating securities which require the use of the two-class method for the computation of basic and diluted earnings per share. We excluded 5,443,797 OP units from the calculation of diluted earnings per share for each of the three and six month periods ended June 30, 2010 and 2009, because their effect would be anti-dilutive.

For the three month periods ended June 30, 2010 and 2009, distributions of \$67,000 and \$71,000, respectively, were made to the holders of certain restricted common shares, of which \$62,000 and \$64,000, respectively, were charged against earnings. For the six month periods ended June 30, 2010 and 2009, distributions of \$138,000 and \$135,000, respectively, were made to the holders of certain restricted common shares, of which \$123,000 and \$121,000, respectively, were charged against earnings. See Note 10 for information related to restricted common shares under the 2008 Plan.

WHITESTONE REIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010
(Unaudited)

(in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Numerator:				
Net income	\$255	\$72	\$590	\$40
Less: Net income attributable to noncontrolling interests	(89)	(25)	(207)	(14)
Dividends paid on unvested restricted shares	(5)	(7)	(15)	(14)
Undistributed earnings attributable to unvested restricted shares	-	-	-	-
Net income attributable to common shareholders excluding amounts attributable to unvested restricted shares	\$161	\$40	\$368	\$12
Denominator:				
Weighted average number of common shares - basic	9,845	9,707	9,783	9,707
Effect of dilutive securities:				
Unvested restricted shares	55	192	116	203
Weighted average number of common shares - dilutive	9,900	9,899	9,899	9,910
Earnings Per Share:				
Basic:				